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No. 85-554

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

HUGHES PROPERTIES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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Respondent and amici expend much effort seeking to chart a course through the maze of lower court decisions that have applied the "all events" test in varied factual contexts. They portray these cases as yielding "analytical principles * * * firmly established by the overwhelming weight of precedent," and they urge that our position "ignores this precedent and thus the rule of stare decisis" (N.Y. Life Amicus Br. 3).

We confess that we find the thicket of lower court opinions somewhat harder to negotiate. In our view, they add up to a rather incoherent body of law, yielding results not easy to reconcile either with each other or with cardinal precepts enunciated by this Court. Some

of the cases upon which respondent and amici rely antedated this Court's decision in *American Automobile Ass'n* v. *United States*, 367 U.S. 687 (1961); as Justice Stewart noted in his dissent there (*id.* at 705-706, 713, 715), these cases may well have been disapproved by that decision.[1] A number of the cases come from the Federal Circuit or its predecessor;[2] since the Federal Circuit authored the decision below, they provide no independent support for the holding that we challenge. Many of the cases come from the Ninth Circuit;[3] since the Ninth Circuit wrote *Nightingale* v. *United States*, 68 .2d 611

[1] See, *e.g.*, *Harrold* v. *Commissioner*, 192 F.2d 1002 (4th Cir. 1951) (reserve for liability to restore strip-mined land); *Denise Coal Co.* v. *Commissioner*, 271 F.2d 930 (3d Cir. 1959) (same); *Schuessler* v. *Commissioner*, 230 F.2d 722 (5th Cir. 1955) (reserve for liability to discharge guaranties); *Beacon Publishing Co.* v. *Commissioner*, 218 F.2d 697 (10th Cir. 1955) (taxability of prepaid subscription income); *Pacific Grape Products Co.* v. *Commissioner*, 219 F.2d 862 (9th Cir. 1955) (reserve for future shipping costs). These cases are discussed and relied upon at Resp. Br. 11, 12, 14, 15; N.Y. Life Amicus Br. 11, 15; and Transamerica Amicus Br. 5, 7, 14, 16, 17, 20.

[2] *E.g.*, *General Dynamics Corp.* v. *United States*, 773 F.2d 1224 (Fed. Cir. 1985), petition for cert. pending, No. 85-1385; *Zwicker Knitting Mills* v. *United States*, 80-2 U.S. Tax Cas. (CCH) ¶ 9832 (Ct. Cl. 1980); *Crucible Inc.* v. *United States*, 591 F.2d 643 (Ct. Cl. 1979); *Eastman Kodak Co.* v. *United States*, 534 F.2d 252 (Ct. Cl. 1976); *Inland Steel Co.* v. *United States*, 76-2 U.S. Tax. Cas. (CCH) ¶ 9791 (Ct. Cl. 1976); *Washington Post Co.* v. *United States*, 405 F.2d 1279 (Ct. Cl. 1969). See Resp. Br. 14, 15, 18; N.Y. Life Amicus Br. 5, 10, 11, 13, 14, 18; Transamerica Amicus Br. 6, 7, 12.

[3] *E.g.*, *ESCO Corp.* v. *United States*, 750 F.2d 1466 (9th Cir. 1985); *Kaiser Steel Corp.* v. *United States*, 717 F.2d 1304 (9th Cir. 1983); *World Airways, Inc.* v. *Commissioner*, 564 F.2d 886 (9th Cir. 1977); *Wien Consolidated Airlines, Inc.* v. *Commissioner*, 528 F.2d 735 (9th Cir. 1976); *Crescent Wharf & Warehouse Co.* v. *Commissioner*, 518 F.2d 772 (9th Cir. 1975); *Pacific Grape Products Co.* v. *Commissioner*, 219 F.2d 862 (9th Cir. 1955). See Resp. Br. 11, 12, 14, 18, 20; N.Y. Life Amicus Br. 7, 8, 10, 11, 13, 17, 19, 20.

(1982), the decision in conflict with the decision below, and upon whose reasoning we rely, they scarcely constitute "established precedent" (N.Y. Life Amicus Br. 4) in support of respondent's position. And one important group of cases, from which respondent and amici seek to derive the linchpin of their argument, actually supports, as we shall explain below, not respondent's position but ours.

We think that one will find little profit and less cheer in seeking the bottom of this pit. We have long viewed the lower courts' case law concerning the all events test as unsatisfactory, both because it lacks intellectual coherence and because (to be frank) we have tended to lose too many cases that we should have won. The decision below for the first time produced a square conflict in the circuits that has enabled us to seek this Court's review. Now that the question is here, we think it should be answered by resort to first principles and common sense. It is to those that we now turn.

1. Respondent contends (Br. 7) that "the fact of [its] liability for the jackpots resulted from [its] operation of progressive slot machines on its casino floor." This contention rests on the theory that Nevada gaming establishments do business within a regulatory framework, marked out by the Gaming Commission's policies and rules, which make it likely that progressive jackpots will eventually be paid. Amici similarly urge this Court to adopt "the general principle that * * * statutory, regulatory, and contractual obligations * * * create liability with sufficient initial certainty to satisfy the all events test" (N.Y. Life Amicus Br. 20; see Transamerica Amicus Br. 5-6). In essence, respondent and amici argue that the mere status of being a gambling casino operator, given the existence of the Gaming Commission's rules, creates a "fixed and unconditional" liability for progressive jackpots (Resp. Br. 9).

This argument misconceives the kind of liability that is relevant in applying the all events test. That test pre-

supposes, not an abstract, inchoate, or generalized obligation, but the specific obligation *to make a payment*. As this Court wrote in *United States* v. *Anderson*, 269 U.S. 422 (1926), an expense is properly deductible for federal tax purposes when all the events have occurred that fix its amount and "determine the liability of the taxpayer to pay it" (269 U.S. at 441).

Generally speaking, statutes and regulations do not, in and of themselves, impose upon particular persons the obligation to pay particular sums. Rather, they subject a class of regulated persons to an inchoate obligation to make payments upon the occurrence of specified facts or conditions. It is not merely the existence of a statute, in other words, but the conjunction of the statute with the happening of the relevant events, that causes the inchoate liability inherent in the regulatory framework to ripen into a concrete obligation on the part of a particular individual to pay something to someone.

This point may be illustrated by *United States* v. *Anderson*, the decision in which the "all events" test was enunciated. The taxpayer there was a manufacturer of munitions and, as such, was subject to federal excise tax on munitions that it manufactured and sold (269 U.S. at 435, 440-441). This Court held that, in computing the taxpayer's income tax liability for 1916, it was proper to accrue a deduction for the excise tax payable with respect to munitions manufactured and sold by the taxpayer during 1916, even though actual payment of the excise tax was not due until the following year (*id.* at 440-441). Contrary to the contention of amicus (N.Y. Life Amicus Br. 9), the Court in reaching that conclusion did not rely merely on the existence of the munitions tax statute, or on the taxpayer's status as a munitions manufacturer. Rather, the Court relied on the fact that the taxable events giving rise to the manufacturer's 1916 munitions tax liability—namely, the manufacture and sale of munitions during 1916—had by definition occurred as of December 31 of that year. It was the

happening of those taxable events that converted the inchoate obligation represented by the excise tax law into a concrete liability to pay the tax.

This Court's reasoning in *Anderson* shows the error of respondent's argument here. In order to accrue a deduction for progressive jackpots as an "expense incurred," it is not sufficient that respondent operates a casino with slot machines on the floor or that respondent does business subject to the supervision of the Nevada Gaming Commission. The Commission's regulations do not require respondent to pay a jackpot unless and until it is actually won by a customer, just as the statute involved in *Anderson* did not require the manufacturer to pay a munitions tax unless and until munitions were actually manufactured and sold. Until a customer has hit the winning combination of symbols, the Nevada regulatory scheme is but a brooding omnipresence. The event that causes this inchoate obligation to ripen into the liability *to make a payment* is the winning pull of the slot machine handle. Until that event occurs, "all the events" necessary to fix the casino's liability to pay a particular progressive jackpot have not materialized.

2. In arguing that its year-end jackpot liabilities are "fixed and unconditional," respondent relies chiefly upon the Gaming Commission regulation that prohibits casinos from turning back the meters on their progressive slot machines (Br. 9). As we showed in our opening brief (U.S. Br. 15-16), however, this regulation, while obviously relevant in determining the *amount* of respondent's *potential* year-end obligation, and thus in determining whether respondent might satisfy the *second* part of the all events test, has absolutely no relevance in determining whether the first, or "fixed liability," component of that test has been met.

This point may be demonstrated by considering what life was like for Nevada casinos before the Gaming Commission propounded the regulation in question. Previously, a casino surely had a contractual obligation to

pay to a winning customer whatever amount was shown on the progressive jackpot meter at the moment of victory. This contractual obligation was buttressed by regulatory requirements, since the Gaming Commission was apparently authorized to impose fines or other sanctions upon casinos that wrongfully refused to pay a progressive jackpot or other prize to a winning customer. See Nev. Rev. Stat. § 463.310 (1967); J.A. 53-54, 59, 77. This contractual and regulatory obligation, of course, was contingent at the close of the taxable year, for neither the casino's implied contract with its customers nor the Gaming Commission's regulations required a casino to pay a jackpot unless (1) a customer gambled the requisite amount of money and (2) the winning combination of symbols appeared on the face of the machine.

The Commission's promulgation in September 1972 of its rule prohibiting the turning back of jackpot meters in no way changed the contingent nature of this year-end obligation. That rule provided merely that "[n]o payoff indicator shall be turned back to a lesser amount, unless the amount by which the indicator has been turned back is actually paid to a winning player" (Nev. Gaming Reg. § 5.110(2) (1972) (reprinted in J.A. 55)). Since this new rule did not require a jackpot to be paid unless won, the rule did not alter the terms of a casino's preexisting contractual and regulatory obligation, which was to pay a jackpot if and only if (1) a customer gambled the requisite amount of money and (2) the winning combination of symbols appeared on the face of the machine.

The principal effect of promulgating the rule against turning back jackpot meters was to lend certainty to the *magnitude* of the casino's contingent liability at the close of its fiscal year. From a financial-accounting standpoint, what prevented a casino prior to September 1972 from accruing its year-end progressive jackpot liability was not the contingent nature of that liability, for, as we have noted (U.S. Br. 25), financial accounting often requires that contingent liabilities be accrued. The difficulty, rather, was that the amount of the liability could not reasonably be estimated. Since a casino was theoretically free to turn back the jackpot meters, there was no assurance that the year-end amounts registered on those meters would still be there when the winning pull of the handle occurred some months or years down the road.

The promulgation of the Commission's rule in September 1972 mitigated this latter uncertainty, since that rule placed a floor, in an amount equal to the year-end meter totals, beneath the casino's potential obligation. Because financial accounting principles "typically require that a liability be accrued as soon as it can reasonably be estimated" (*Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 543 (1979) (footnote omitted)), respondent's accountants determined that those year-end sums should thenceforth "be reported on the financial records of the corporation as accrued liabilities" (J.A. 68, 69). But that does not mean that respondent was entitled to deduct those sums for tax purposes as well. The "all events" test requires not only that the amount of the putative deduction be determinable with reasonable accuracy, but also that the taxpayer have incurred a fixed and unconditional obligation to pay it. As we have shown, respondent had no obligation to pay a jackpot unless and until somebody won it, and the Gaming Commission's new rule had no effect on the contingent nature of that promise. Respondent was thus in no better position after September 1972 than previously to claim a tax deduction for the year-end amounts shown on its jackpot meters.[4]

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[4] Amicus Atlantic City Casino Association endeavors to show "[t]he fixed quality of the accrued jackpot" by hypothesizing that "[a]ny party purchasing a casino property would have to recognize the accrued progressive jackpots as a liability to be assumed" (Br. 9). Although this hypothesis may be correct, the conclusion does not follow from the premise. Contingent liabilities, no less than fixed liabilities, are commonly assumed by purchasers in inter-

3. Respondent and amici dismiss the actual winning of the jackpot by a customer as an event that "ha[s] no effect upon the existence of * * * liability" (N.Y. Life Amicus Br. 13; Resp. Br. 14). As they see it, the casino's obligation is unconditionally fixed when "a machine is introduced on the casino floor" (Resp. Br. 9); the winning pull of the handle, they contend, merely determines the precise amount of the jackpot, the time of actual payment, and "the identity of the ultimate payee" (N.Y. Life Amicus Br. 13; Resp. Br. 14). They assert that "[t]he 'all events' test has never included a requirement that the ultimate payee be identified before an obligation is * * * deductible" (Atlantic City Casino Amicus Br. 10).

We of course agree that, once a taxpayer has incurred an unconditional obligation to make a payment, he may accrue a deduction under the all events test even though payment is not currently due, and even though the amount of the payment is determinable only with "reasonable accuracy" (Treas. Reg. § 1.461-1(a)(2)) rather than with perfect precision. That much has been clear for fifty years. But we cannot so readily assent to respondent's assertion about the relevance of "inability to identify the payee" (Resp. Br. 14). That assertion blurs, with what seems studied ambiguity, several ideas that need to be unbundled.

In support of this assertion, respondent and amici rely on a series of lower court decisions involving what may be called "group liabilities."[5] The taxpayer in these cases

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corporate transactions. A buyer, for example, will often assume a seller's liability on pending contested lawsuits. The fact that a liability is capable of assumption thus tells one nothing about whether it is a "fixed" or "contingent" liability for tax accounting purposes.

[5] *E.g.*, *Lukens Steel Co.* v. *Commissioner*, 442 F.2d 1131 (3d Cir. 1971); *Washington Post Co.* v. *United States*, 405 F.2d 1279 (Ct. Cl. 1969); *Willoughby Camera Stores* v. *Commissioner*, 125 F.2d 607 (2d Cir. 1942); *Inland Steel Co.* v. *United States*, 76-2 U.S. Tax Cas. (CCH) ¶ 9791 (Ct. Cl. 1976); *Reynolds Metals Co.* v. *Commissioner*, 68 T.C. 943 (1977). See Resp. Br. 14, 15; N.Y. Life Amicus Br. 10, 11, 13, 14; Atlantic City Casino Amicus Br. 10, 11.

[6] The Commissioner originally declined to follow both *Washington Post Co.* and *Lukens Steel Co.* See Rev. Rul. 76-345, 1976-2 C.B. 134; Rev. Rul. 72-34, 1972-1 C.B. 132. However, in view of the government's persistent lack of success on this issue in the Federal Circuit, a court of nationwide jurisdiction, the Commissioner now rarely challenges deductions in such "group liability" situations, at least where the employer has an unconditional year-end liability to make irretrievable payment to some separate entity like a trust.

is typically an employer that has incurred, by virtue of his employees' past services, a fixed and unconditional obligation to make a payment on their behalf. The immediate payee is generally a fund or trust—*e.g.*, a profit-sharing plan or a supplemental unemployment benefit trust—of which the employees as a class are beneficiaries. In the typical case, the identities of the ultimate employee-beneficiaries, and the exact amounts of their respective beneficial interests, are not known at the close of the tax year. The lower courts have generally permitted the employer to deduct his year-end liability in these circumstances, reasoning that the employer has an unconditional obligation to make payment irretrievably *to the entity*, even though the individuals who comprise the class of beneficial owners may be unidentified.

We may assume for present purposes that these "group liability" cases were correctly decided.[6] But their rationale offers no support for respondent's position. Respondent at the close of its tax year has incurred no liability to make payment to a plan, trust, or other entity; on the contrary, respondent has no obligation to pay a jackpot to anyone or anything unless somebody wins it. We have little doubt that, if respondent's jackpots had in fact been won before the close of its tax year, it would be entitled to a deduction even though it did not happen to know the winners' names. What prevents a deduction in our view is not that respondent does not know the names of the payees, but that *no payees exist* at the close of the

tax year. An unconditional obligation presupposes both an obligor and an obligee. The obligee may be an individual or an entity; the obligee may be identifiable or unknown; but there must be an obligee.

Our point may be illustrated by a pair of examples. Assume that a manufacturer has suffered a serious industrial accident that has injured many people in the area surrounding its plant. Assume that the manufacturer, before the close of its tax year, has unconditionally agreed, based on negotiations with representatives of the injured parties, to make a payment in an ascertainable amount to a trust for the benefit of those persons. Assume that no portion of this payment can ever revert to the manufacturer, but must inevitably be distributed to members of the class. In our view, the manufacturer would be entitled under the "all events" test to a deduction for the amount it had committed to pay the trust, even though the names of the ultimate beneficiaries might not then be known.[7]

On the other hand, assume that a sporting goods company has committed itself to hold a golf tournament during the next year, or annually for each of the next 10 years. Assume that the company has offered prize money of $1 million for each tournament, to be shared among each event's top 50 golfers. Assume that state law requires this offer to be irrevocable, and that the tournaments in the normal course of business must be held. In our view, the company would not be entitled to deduct, in the year it announces the future tournament or tournaments, the sum that it has offered by way of prizes.

[7] In 1984, Congress amended the Code to provide that, in order to deduct expenses attributable inter alia to tort liabilities, a taxpayer must satisfy, not only the "all events" test, but also a new "economic performance" test. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 91(a), 98 Stat. 598-601 (adding I.R.C. § 461(h)). See U.S. Br. 29-30 n.4. The new law generally provides that, where a taxpayer's liability requires payment to another person and arises out of a tort, "economic performance occurs as payments to such person are made" (I.R.C. § 461(h)(2)(C)(ii)). The Treasury Department has not yet issued regulations concerning this provision. See I.R.C. § 461(h)(2) (first clause).

What prevents such an accrual is not the fact that the company is unable to name the golfers who will win the tournaments. It is, rather, the fact that the tournaments have not yet been held and the prizes have not yet been won.

Needless to say, we think that the latter example rather closely resembles the situation here. As noted in our opening brief (at 21), respondent's obligation with respect to its progressive jackpots is in the nature of the offer of a prize, a prize that may be won if and when some future patron pays his money and hits the winning combination of symbols. Indeed, the Nevada Gaming Commission's rules specifically describe progressive jackpots as being "offered to the public as prizes" (J.A. 56). So long as respondent chooses to stay in the gaming business, those rules require that respondent's offer be irrevocable. But respondent's *liability* on the offer is nevertheless contingent until someone *accepts* the offer by satisfying the conditions for payment. Respondent does not have an "unconditional liability" unless there exists some person or entity to whom it is liable, and respondent is not liable to anyone until somebody wins the prize.[8]

4. As a framework for deciding cases under the all events test, amicus New York Life proposes an analysis based on "conditions precedent" and "conditions subse-

[8] Respondent asserts that, even if one accepts our intention that an obligation presupposes an obligee, "there is no absence of obligees in this case"; as respondent sees it, the Nevada regulatory scheme imposes on casinos an "unconditional liability to the gaming public" (Br. 15). "The gaming public," however, is indistinguishable from "the world at large"; an obligation to the world at large is the very sort of abstract liability that cannot support a deduction under the all events test. See pages 2-5, *supra*. "The gaming public" does not define a class of beneficiaries whose past services give them enforceable rights to a trust corpus. Compare, *e.g., Willoughby Camera Stores*, 125 F.2d at 609. To the contrary, "the gaming public" is but a tautological description of the population from which possible future jackpot winners—who by definition will be members of the gaming public—must inevitably come. A "liability to the gaming public" is but a substitute for a "contingent liability."

quent" (N.Y. Life Amicus Br. 3-15). In its view, a "condition precedent" is a fact or event whose occurrence is necessary to create a tax-deductible liability. A "condition subsequent" is a fact or event which "may act to terminate an existing liability" and whose possible future occurrence should not prevent accrual (*id.* at 6). Other events, such as those which "affect the timing or manner in which [the] liability is ultimately paid or satisfied, or the identity of the ultimate payee," are said to be neither "conditions precedent" nor "conditions subsequent" and to "have no impact on accruability" (*id.* at 6, 13). Amicus says that this mode of analysis, derived from the law of contracts, is "uniformly recognized in the application of the all events test" (*id.* at 6-7).

The mode of analysis that amicus proposes is certainly not "uniformly recognized" (N.Y. Life Amicus Br. 6) in this Court's tax decisions; in fact, amicus cites no case in which this Court has employed it. Although "condition precedent" and "condition subsequent" crop up occasionally in lower-court exegeses of the all events test (see *id.* at 12-13), that mode of reference, far from being "firmly established by the overwhelming weight of precedent" (*id.* at 3), is quite desultory and haphazard. And while the analytical framework that amicus proposes may seem tempting to those of a philosophical bent—it is a temptation to which we have succumbed (Reply Memo. 3)—we doubt that it will prove, in the generality of cases, an auspicious road down which to travel.

The distinction between a "condition precedent" and a "condition subsequent" is a point of metaphysics with which the law of contracts grappled long and unsuccessfully. "In one sense," Holmes wrote, "all conditions are subsequent; in another, all are precedent." *The Common Law* 316 (1938 ed.)[9] "The truth is that [these] terms

[9] Less epigrammatically, Holmes' discussion of the matter (*The Common Law*, *supra*, at 316-318) was as follows:

> The conditions which a contract may contain have been divided by theorists into conditions precedent and conditions subsequent. The distinction has even been pronounced of great importance. It must be admitted that, if the course of pleading be taken as a test, it is so. In some cases, the plaintiff has to state that a condition has been performed in order to put the defendant to his answer; in others, it is left to the defendant to set up that a condition has been broken. * * * * * The point at which the law calls on the defendant for an answer varies in different cases. Sometimes it would seem to be governed simply by convenience of proof, requiring the party who has the affirmative to plead and prove it. Sometimes there seems to be a reference to the usual course of events, and matters belong to the defence because they are only exceptionally true.

are meaningless until the fact constituting the condition is related to something else. If it is precedent, it must be precedent to something; and if it is subsequent, it must be subsequent to something. Therefore, the first question must always be: Precedent to what? and subsequent to what?" 3A A. Corbin, *Corbin on Contracts* § 739, at 442 (1960 ed.). After struggling for years with these questions, modern scholars have generally found much wisdom in "Holmes' skeptical approach to the validity of the distinction between conditions precedent and subsequent." F. Kessler & G. Gilmore, *Contracts* 823 (2d ed. 1970). See L. Fuller & R. Braucher, *Basic Contract Law* 633-636 (1964). Indeed, the Second Restatement of Contracts revised its predecessor "to eliminate the terms 'condition precedent' and 'condition subsequent,'" the reporters noting that "[t]his terminology has long been criticized and has caused confusion * * *." Restatement (Second) of Contracts § 224 & reporter's note (1981). Scholars have suggested that these terms are best viewed as "ghosts from the Nineteenth Century." J. Jackson & L. Bollinger, *Contract Law in Modern Society* 1046-1049 (1980).[10]

[10] At the margins, of course, a mode of analysis based on "conditions precedent" and "conditions subsequent" may seem to produce sensible results. A person's signing of a contract may generally be described as a "condition precedent" to his liability on the contract; and a discharge in bankruptcy may usually be described as a "condition subsequent" that divests him of an existing obligation. But the distinction is of little use in complex cases presenting nicer questions. It often happens, for example, that an employer will have an obligation to make future payments on

If one were to adopt the mode of analysis that amicus proposes, it seems to us that the inquiry would lead in any event to the result that we urge. In deciding whether the winning pull of a slot machine handle (or anything else) is a condition precedent, "the first question must always be: Precedent to what?" (3A A. Corbin, *supra*, at 442). The "what" for purposes of the all events test is, as we have shown (pages 3-4, *supra*), the liability to make a payment. Since respondent has no liability to make a payment of a progressive jackpot unless and until someone wins it, the winning pull of the handle, as the Ninth Circuit reasoned, is "most naturally regarded as a condition precedent" to the creation of a fixed obligation. *Nightingale* v. *United States*, 684 F.2d 611, 614 (1982).[11]

5. In our opening brief (at 21-32), we emphasized the important role that the all events test plays in the system of tax accounting. That test "is designed to assure that taxpayers will not obtain deductions for expenditures that might never occur," and it thus serves the goal of tax accounting by "seek[ing] certainty of liability rather than probability." *World Airways, Inc.* v. *Commissioner*, 62 T.C. 786, 805 (1974), aff'd, 564 F.2d 886 (9th Cir. 1977). We suggested (U.S. Br. 22) that the Federal Circuit's misapplication of the all events test may have owed to a neglect of the distinction, oft recognized in this Court's decisions, between tax and financial accounting. See, *e.g.*, *Thor Power Tool Co.*, 439 U.S. at 538-544; *American Automobile Ass'n*, 367 U.S. at 690-693.

Respondent and amici strive in various ways to evade the force of these decisions. One amicus argues that divergences between tax and financial accounting are "scarcely a matter for celebration" and characterizes our argument as a "makeweight" (Atlantic City Casino Amicus Br. 11 n.9). Respondent asserts that "[t]here is nothing in the opinion of the Federal Circuit to suggest" that the courts below were "influenced * * * by financial accounting principles" (Br. 21) and contends that this issue is not raised here at all. Amicus Transamerica Corporation urges by contrast that the courts below gave "substantial weight" and "particular emphasis to the principles of financial accounting * * * in deciding whether [r]espondent had met the 'all events' test," but contends that those courts acted correctly in doing so (Br. 8, 9, 17). It urges that this Court "should resolve close technical questions of accrual accounting" by considering whether the taxpayer's treatment "complies with generally accepted accounting principles" (*id.* at 8).

The drift of these arguments runs counter to 50 years of this Court's decisions, a fact about which Transamerica is particularly frank. It dismisses *Brown* v. *Helvering*, 291 U.S. 193 (1934), a decision upon which we rely (U.S. Br. 18-20), in a single sentence (Amicus Br. 13). It asserts that a major premise of *American Automobile Ass'n*, 367 U.S. at 694-697, upon which we likewise rely

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account of employees' past services, such payments being conditioned on those individuals' being alive, or still being employed, at the relevant future time. *E.g.*, *Trinity Construction Co.* v. *United States*, 424 F.2d 302 (5th Cir. 1970); *Bennett Paper Corp.* v. *Commissioner*, 699 F.2d 450 (8th Cir. 1983). See U.S. Br. 20-21. In such cases, the employee's continued employment or survival might be called a "condition precedent" whose occurrence is necessary to create a liability; or the employee's termination or death might be called a "condition subsequent" whose occurrence causes forfeiture of the employee's rights and thus divests the employer of an existing liability. In our view, it makes little difference how the condition is described; the relevant question is whether the taxpayer at year's end has a fixed and unconditional obligation to make a payment. The courts of appeals have held that an employer in such situations does not have such an obligation (*Trinity Construction Co.*, 424 F.2d at 305; *Bennett Paper Corp.*, 699 F.2d at 453), and amicus (N.Y. Life Amicus Br. 7) seems to agree with our contention that the courts were correct in so holding.

[11] Amicus asserts (N.Y. Life Amicus Br. 19) that the Ninth Circuit in *Nightingale* "failed even to consider the possibility that the Nevada Gaming Commission regulation might create an existing liability." That assertion is incorrect. The Ninth Circuit discussed the Nevada regulatory scheme, including the regulation in question, at some length (684 F.2d at 612-613).

(U.S. Br. 28-29), is "flatly contradicted by [the] legislative history" cited by the Court (Amicus Br. 21 n.6). It says that *Thor Power Tool Co.*, 439 U.S. at 538-544, involved a "glaringly bad fact situation" that assertedly "led the Court * * * to make some overbroad generalizations about the weight properly to be accorded to generally accepted accounting principles" (Amicus Br. 22). It dismisses various passages in that opinion as "faulty" or "simply wrong," and urges the Court to "clarify" statements that supposedly have "misled many courts" (*id.* at 14 n.4, 26). And in contending that financial accounting principles should carry the day "[a]bsent a countervailing tax policy" or "[w]here the Commissioner cannot demonstrate with certainty that a taxpayer has failed the 'all events' test" (*id.* at 12, 24), amicus urges the very shift in the burden of proof, the very "presumption * * * against the Treasury" (439 U.S. at 539, 540), that the Court in *Thor Power Tool Co.* explicitly rejected.

Transamerica in our view has at least identified the dragon that it must slay. And while we think that this Court's decisions can parry those thrusts without our help, we would make one point about Transamerica's position. Its central thesis is that an expense should be deductible, for tax as for financial accounting purposes, "where incurrence of the liability is 'probable,' *i.e.*, when future events confirming the fact of liability are likely to occur" (Amicus Br. 25). The centrality of this thesis is particularly clear in the instant case, since respondent's incurrence of jackpot liabilities is entirely a function of gambling odds, which reflect the laws of probability in a rather pure form. Amicus acknowledges (*id.* at 25) that "some exercise of judgment may be required in interpreting the word 'probable.'" But it urges the Court to defer on this score to the judgment of taxpayers' accountants, who, by applying "scientific accounting principles" (*id.* at 2, 11, 14, 15, 16), should decide when expenses are sufficiently likely to occur so as to be deductible in computing taxable income.

As we have noted (U.S. Br. 31-32), Transamerica's argument is precisely the argument that the Court in *Thor Power Tool Co.* explicitly rejected. The tax laws, the Court said, cannot tolerate an outcome under which a taxpayer "could decide unilaterally—within limits dictated only by its accountants—the tax it wished to pay" (439 U.S. at 544). The Court emphasized that what amicus calls "scientific accounting principles" (Transamerica Amicus Br. 2, 11, 14, 15, 16) actually permit "a range of 'reasonable' treatments, leaving the choice among alternatives to management" (439 U.S. at 544).[12] The Court quite properly held that such variances are unacceptable "in a tax system designed to ensure as far as possible that similarly situated taxpayers pay the same tax" (*ibid.*). There is no reason for the Court to depart from that holding here.

CONCLUSION

For these reasons and those set forth in our opening brief, it is respectfully submitted that the judgment of the court of appeals should be reversed.

CHARLES FRIED
Solicitor General

APRIL 1986

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[12] Indeed, the Court noted one commentator's suggestion that accountants "are quite prone to define 'generally accepted' as 'somebody tried it'" (439 U.S. at 544 n.2, quoting Cannon, *Tax Pressures on Accounting Principles and Accountants' Independence*, 27 Acct. Rev. 419, 421 (1952)).

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